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SUBJECT: 2005-2006 INTERNATIONAL NARCOTICS CONTROL
STRATEGY REPORT (INCSR) PART II, MONEY LAUNDERING AND
FINANCIAL CRIMES, SRI LANKA

Ref: STATE 210691

1. UPDATED RESPONSE TO REFTEL FOLLOWS:

2. Sri Lanka is neither an important regional financial center nor a preferred center for money laundering. Money laundering currently is not a criminal offense. There are strict bank secrecy laws, under which the Government of Sri Lanka is required to obtain a court order to obtain banking information on bank customers. The Central Bank introduced regulations on customer due diligence in a December 2001 bid to tackle money laundering and terrorist financing in the absence of a specific legal framework. These regulations apply to commercial banks and licensed specialized banks coming under the Central Bank. In June 2005, the Central Bank tightened the rules for the appointment of money changers.

3. The Government has finalized three separate laws to deal with money laundering and terrorist financing. The Convention on the Suppression of Terrorist Financing, Act 25 of 2005, was passed by Parliament in August 2005. This law gives effect to the UN Convention for the Suppression of the Financing of Terrorism. The remaining two draft laws, a law for the prevention of money laundering and a law on financial transactions reporting, modeled on those in the Commonwealth, which will provide for the establishment of a financial intelligence unit (FIU), have been finalized and await Parliamentary approval. The passage of these two laws was delayed due to the November 17 Presidential elections and the Government of Sri Lanka (GSL) Budget presentations in November and December 2005. The laws were tabled in Parliament in early December and expected to be passed into law soon. The Government expects to create an FIU, most likely housed in the Central Bank, following the passage of the laws. Currently, financial transactions relating to terrorism and narcotics are illegal under Central Bank regulations and banking laws.

4. The definition of money laundering, under the proposed anti-money laundering law, covers (as predicate offenses) the offenses under existing laws on narcotics, terrorism prevention, bribery, firearms, exchange control, banking, transnational organized crime, cyber crimes, child protection and trafficking of persons and any other offense punishable by death or imprisonment of seven years or more. The offense of money laundering involves receiving, possessing, concealing, disposing of, importing, exporting, investing or dealing in any property or proceeds derived or realized from any unlawful activity covered by the law. Under the sentencing provisions of the proposed anti-money laundering law, persons convicted will be liable for a fine or imprisonment for a period of 5-20 years. Under the sentencing provisions of the recently enacted counterterrorist financing law, persons convicted will be liable for a fine and imprisonment for a period of 15-20 years. Under the laws, both money laundering and terrorist financing would be extraditable offenses.

5. Many areas of concern exist with respect to Sri Lanka's current anti-money laundering efforts. The Central Bank continues to allow the operation of bearer certificates of deposits. In July 2003, in order to limit money laundering through bearer certificates, the Central Bank required banks to maintain a record of purchasers of these certificates. However, in reality, the banks currently maintain records of the initial purchaser and the ultimate bearer who turns in a bond to the bank. Meanwhile, the bond may transfer through other hands.

6. Another area of concern relates to a 2003 tax amnesty, under which Sri Lankan individuals and companies could declare previously undisclosed wealth accrued from any source and receive immunity from a range of taxes. The amnesty was revised in 2004, so

that immunity is now only available with respect to the payment of income tax on relevant funds. Casinos, jewelry shops and dealers in gems are also areas of concern, as there is no law to regulate their operations.

17. Sri Lanka has an indigenous alternative remittance system in the form of informal money transfer operations. Many Sri Lankan migrant workers, mainly in the Middle East, use this hawala-like system to remit their earnings. Various payments out of Sri Lanka are also made using this system. Sri Lankan commercial banks are increasing their presence and services in the Middle East in order to cater to this clientele. Trafficking of drugs generates significant amounts of criminal proceeds, and those proceeds are also readily transported using this system. Drug proceeds are laundered through various methods, including investment in real estate. In November 2004, a high court judge who was presiding over several narcotics related cases was killed at his home. A known drug peddler and four others were found guilty of the murder and sentenced to death.

18. Sri Lanka is also saddled with a long running terrorist problem. Liberation Tigers of Tamil Eelam (LTTE), a terrorist organization seeking an independent homeland, has been operating in Sri Lanka for over 20 years. In February 2002, with Norwegian Government facilitation, the LTTE and the Government of Sri Lanka agreed to a joint cease-fire accord. After holding six rounds of talks, the LTTE withdrew from the negotiation process in April 2003. In November 2005, the newly elected Sri Lankan President invited the LTTE to resume negotiations but there has been no response as yet. Since October 1997, the U.S. Government has designated the LTTE as a Foreign Terrorist Organization under provisions of the Anti-Terrorism and Effective Death Penalty Act of 1996. The Government of Sri Lanka lifted a proscription on the LTTE consequent to the peace process in 2001. However, the LTTE is still designated as a terrorist organization under "UN Regulation 1 of 2001" made under United Nations Act No 45 of 1968. This regulation was introduced by the Ministry of Foreign Affairs to give effect to binding obligations under UN Security Council resolution 1373. Under the regulation, funds cannot be remitted to the LTTE.

19. Following the December 2004 tsunami, a large number of international and local Non Governmental Organizations (NGOs) have opened offices in Sri Lanka. In order to ensure the legitimacy of the NGOs, the Government created a Center for Non Government Sector (CNGS) in the Ministry of Finance. NGOs require a recommendation from the CNGS to register as a NGO. Further, NGOs receiving Tsunami related funds from abroad are required to channel these funds through a Special Bank Account titled "Post Tsunami Inward Remittances Account" (PTIRA). All registered banks in Sri Lanka are allowed to open such accounts. The banks are required to forward monthly statements on these accounts to the Exchange Control Department of the Central Bank. The Central Bank reports that existing arrangements are inadequate to monitor financial flows to NGOs.

110. Sri Lanka is not considered an offshore financial center. Offshore banking units are allowed to operate as a part of a commercial bank operating in an overseas country in order to facilitate trade finance. They are subject to Central Bank supervision. Bearer shares are not permitted for offshore banks and foreign-owned companies. Sri Lanka has 10 free trade zones, also called export-processing zones, administered by the state-owned Board of Investment (BOI). The free trade zones house export-manufacturing operations. Only companies approved by the BOI are allowed to operate inside the zones. There are no indications that these free trade zones are being used in trade-based money laundering schemes or terrorist financing.

111. Sri Lanka is a party to the UN International Convention for the Suppression of the Financing of Terrorism and to the 1988 UN Drug Convention. Sri Lanka is also a party to the UN Convention against Corruption. Sri Lanka has signed but not ratified the UN Convention against Transnational Organized Crime. Sri Lanka is a member of the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) working group on Counter-Terrorism and Transnational Crime formed in July 2004. The working group had its first meeting in December 2004 and aims to serve as a platform for regional cooperation to prevent and suppress terrorism and transnational crime.

112. The Mutual Assistance in Criminal Matters Act of 2002 provides for cooperation in criminal matters with Commonwealth countries and with non- Commonwealth

countries with which Sri Lanka has entered into a bilateral agreement on mutual assistance in criminal matters. Under the newly enacted Convention on the Suppression of Terrorist Financing Act No 25 of 2005, which gives effect to the UN International Convention for the Suppression of the Financing of Terrorism, and the draft law on the Prevention of Money Laundering the government is required to co-operate with and provide assistance to states party to the Convention with regard to investigations and prosecutions under the respective laws. The Central Bank of Sri Lanka has circulated the list of individuals and entities that have been included on the UNSCR 1267 Sanctions Committee's consolidated list with instructions to identify, freeze and seize terrorist assets. To date, no such assets have been identified.

¶13. Terrorist financing is an offense punishable by imprisonment for a period of five to ten years. Regulations under the United Nations Act No. 45 of 1968 provide for the freezing and forfeiture of assets of financiers of terrorism. There is no specific provision in law for the freezing and forfeiture of narcotics-related assets. The trafficking, possessing, importing or exporting of narcotics is punishable by death or life imprisonment under the Poisons, Opium and Dangerous Drugs Ordinance (OPDDO). Draft amendments to OPDDO, and draft money laundering and the terrorist financing legislation include asset forfeiture and seizure provisions for narcotics related crimes, money laundering and terrorist financing.

¶13. The Government of Sri Lanka has accepted US Government assistance to implement its anti money laundering and counterterrorist financing programs. The US Treasury's Financial Crimes Enforcement Unit conducted three training seminars in Sri Lanka for officers from regulatory and reporting agencies during 2004-2005. The US Department of Justice also conducted a regional workshop on detecting and preventing terrorist financing in Sri Lanka in June ¶2005. Officials from several Sri Lankan government agencies attended the workshop along with officials from several other countries in South Asia. US Treasury intends to place a full time technical advisor on anti money laundering related matters in Sri Lanka in summer 2006.

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